



Final Limited Market Conduct Examination
by the Montana Department of Insurance
840 Helena Avenue
Helena, MT 59601

of

American Economy Insurance Company
American States Insurance Company
First National Insurance Company of America
General Insurance Company of America
Safeco Insurance Company of America
Safeco Insurance Company of Illinois
Safeco National Insurance Company
Home Office
Safeco Plaza
Seattle, Washington 98185

As of 6/30/2004

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SCOPE OF THE EXAMINATION

This is a report of the limited market conduct examination of the following Safeco Corporation insurance subsidiaries: American Economy Insurance Company, American States Insurance Company, First National Insurance Company of America, General Insurance Company of America, Safeco Insurance Company of America, Safeco Insurance Company of Illinois and Safeco National Insurance Company. These companies are referred to as the "Company" or the "Companies" or as Safeco. The examination covers the time period from January 1, 2000, through June 30, 2004.

This examination was conducted pursuant to the provisions of §§ 33-1-401, MCA and in accordance with the procedures and guidelines in the *Market Conduct Examiners Handbook* as adopted by the National Association of Insurance Commissioners (NAIC).

The examination included the review of the following:

1. underwriting;
2. use of credit scores;
3. claims handling primarily in personal lines automobile insurance.

The State Auditor and Commissioner of Insurance and Securities is hereinafter referred to as the Commissioner and the Department of Insurance of the state of Montana is hereinafter referred to as the Insurance Department. The findings of the examination are by exception and by test.

COMPANY OPERATIONS AND HISTORY

Safeco Corporation is a publicly-owned holding company that manages the affairs of fourteen insurance subsidiaries which provide a full line of property and casualty insurance products in Montana. Safeco Corporation's insurance products are sold by independent agents.

The following is a brief history of the seven Companies subject to this examination:

- American Economy Insurance Company was incorporated on September 23, 1959, under the laws of Indiana. American Economy was issued a Certificate of Authority to do business in Montana on November 09, 1965. Safeco Corporation acquired American Economy in 1997; the name has remained the same.
- American States Insurance Company was incorporated as American Automobile Insurance Company on July 15, 1929, under the laws of Indiana. The name was changed to its present name in 1930. American States Insurance Company

received a Certificate of Authority to do business in Montana on November 9, 1965, and was acquired by Safeco Corporation in 1997.

- First National Insurance Company of America was incorporated October 28, 1928, under the laws of Washington and received a Certificate of Authority to do business in Montana on August 6, 1929.
- General Insurance Company of America was incorporated May 1, 1923, under the laws of Washington and received a Certificate of Authority to do business in Montana on March 2, 1927.
- Safeco Insurance Company of America was incorporated as Selective Auto and Fire Insurance Company on September 2, 1953, under the laws of Washington. The Company received a Certificate of Authority to do business in Montana on October 27, 1953, and changed to its present name on November 2, 1953.
- Safeco Insurance Company of Illinois was incorporated on August 29, 1980, under the laws of Illinois and received a certificate of Authority to do business in Montana on October 22, 1984.
- Safeco National Insurance Company was incorporated on July 10, 1972 under the laws of Missouri and received a Certificate of Authority to do business in Montana on February 14, 1992.

The Safeco Companies write over 10% of the personal lines auto business in Montana. The following shows a material change in the Inter-Company mix between 2002 and 2003.

NAIC Cocode	Company Name	Premiums			Market Share		
		2004	2003	2002	2004	2003	2002
19690	American Economy Ins Co	0	-3	53,480	0.000%	0.000%	0.013%
19704	American States Ins Co	0	249	10,717	0.000%	0.000%	0.003%
24724	First Natl Ins Co of Amer	2,718,677	2,297,675	930,624	0.552%	0.491%	0.220%
24732	General Ins Co of Amer	250	-3,224	589,032	0.000%	-0.001%	0.139%
24740	Safeco Ins Co of Amer	7,498,379	6,381,807	31,455,405	1.522%	1.364%	7.436%
24759	Safeco Natl Ins Co	0	0	42,573	0.000%	0.000%	0.010%
39012	Safeco Ins Co of IL	50,352,614	44,623,690	10,879,799	10.223%	9.538%	2.572%

COMPLAINTS

The Insurance Department experienced a marked increase in complaints during the time period covered by this examination, and the Department staff noted repetition of issues relating to the underpayment or non-payment of policy benefits or liability for Loss of Use. Several underwriting complaints referred to large premium increases in 2001 and 2002 and questions regarding the use of credit in underwriting were raised.

The following table presents a tabulation of the complaints with 1999 shown as a benchmark before the surge in activity. During the year 2003, coincident with a premiums shift from Safeco Insurance Company of America into Safeco Insurance Company of Illinois and First National Insurance Company of America, the Companies rolled out the Safeco New Auto Policy ("SNAP"). This resulted in a large underwriting and rating complaint surge.

Complaint	1999	2000	2001	2002	2003	2004
Underwriting	8	13	19	23	44	24
Claims	45	59	78	47	61	64
Total	53	72	97	70	105	88

The Insurance Department noted that confusion often occurred in attempting to determine which of the SAFECO Companies was the insurer as correspondence was often generic and policies may renew in a different company without proper notice of non-renewal from the affiliate company as required by § 33-15-1105, MCA.

UNDERWRITING REVIEW

1. Use of Credit

A. Notice of Insurance Information Practices

On 3/2/2000 the Companies began using credit to underwrite Montana policies. The February 2000 *BULLETIN to All Montana Agents* announced:

"With the availability of our new auto program, we're introducing insurance scoring. This is a method of qualifying business that many of you already use with other carriers. With profitability so important to all of us, it seemed to be an appropriate time for SAFECO to step to the next level and use a tool that has proven to be one of the best predictors of future losses that we have available...."

This followed the Companies obtaining "...insurance scores on all auto and homeowners policies we had as of October 1999...." The Companies began collecting "credit information" prior to issuing an amended privacy notice in 2002, informing their insureds they were obtaining the insureds' "credit information." Failure to disclose this collection of credit information to consumers prior to 2002 was a violation of § 33-19-202 (3) (a), MCA.

B. Reason for Adverse Underwriting Decisions

The charging of a higher rate is included in the definition of an Adverse Underwriting Decision in § 33-19-104(1)(a)(iv)(B), MCA, since the credit score provides information different from that furnished by the insured. When credit history, wholly or in part, is used to charge a higher rate, notice is required pursuant to § 33-19-303, MCA, advising the insured their credit history caused them to pay a higher rate and informing them of their right to obtain a copy of their credit report. These and related statutes were communicated to the Companies in the September 7, 2001 *ADVISORY MEMORANDUM* sent to all Property and Casualty Insurers.

On 8/29/2002, the Company began placing new business in Montana through a model named Safeco New Auto Policy ("SNAP") which continued the use of Insurance Bureau Scores, referred to as IBS, driving records, and accident histories together with several additional variables. Each variable has a range of Weights, one of which is assigned based on the applicant's characteristic for that variable. These Weights are then totaled and the resulting number (referred to as the "Insurance Score") determines the placement of the risk. Generally, subject to Tier Altering rules applied to specific risks, those with higher Insurance Scores are placed in higher tiers and those with lower Insurance Scores are placed in lower tiers.

Applicants and insureds renewing coverage, who had no driving record violations or at fault accidents and were classed as Good, Fair or No Record on their Insurance Score, would have suffered an Adverse Underwriting Decision as defined in § 33-19-104(1)(a)(iv)(B), MCA, since they could not be placed in the highest tier – charging lowest premiums. Accordingly, they would be entitled to notice required by § 33-19-303, MCA, advising them that their credit history caused them to pay a higher rate and informing them of their right to obtain a copy of their credit report.

Only one policyholder had a credit score high enough for SNAP to assign the greatest Weight allowable for the IBS score. All other policyholders were written under SNAP and could have benefited in lower premiums being charged, resulting from a higher credit score, and were, therefore, subjected to an Adverse Underwriting Decision according to § 33-19-104(1)(a)(iv)(B), MCA. When credit history, wholly or in part, is used to charge a higher rate, the Companies are required to provide notice pursuant to § 33-19-303, MCA, advising policyholders that their credit history caused them to pay a higher rate, and informing them of their right to obtain a copy of their credit report. The

Companies failed to provide this notice to their insureds when the policies were issued resulting in a violation of § 33-19-303 MCA.

2. Inadequate Notice of Cancellation/Non-Renewal

Forms CN-7036/EP 11/97 and CN-7036/EP 2/04 "MONTHLY PAYMENT PLAN CANCELLATION WARNING NOTICE" reflects SAFECO INSURANCE COMPANIES as the insurer and the entity to which premiums are to be remitted. The phrase "SA=SAFECO Insurance Company of America" in the body of the front does not adequately identify the company when "SA" appears on the back under "CO." The same applies when "FN=First National Insurance Company of America" or "SI=SAFECO Insurance Company of Illinois" are used. The letterhead and the remittance address should state Safeco Insurance Company of America. Five policies in the sample were noted with these errors.

The Company utilized a process of non-renewal which is referred to as a Soft DNR when one SAFECO Company is non-renewing its policy but an affiliate is issuing a new policy on the same risk. The Company terminating coverage is required to give notice of non-renewal. The affiliated Company intended to issue replacement coverage can make its offer contemporaneous with the notice of non-renewal. However, failure to provide the required notice of non-renewal as required by statute constitutes a violation of § 33-15-1105(1) (a), MCA.

3. Discrimination in Pricing Without Documentation of No Prior Insurance

Four policies from the sample were rated at a lower tier, resulting in higher premiums because they purportedly had no prior insurance. However, the files did not contain proper documentation of no prior insurance as required by the Administrative Rules of Montana, 6.6.3303 and 6.6.3304.

CLAIMS REVIEW

A total of 150 vehicle claims were randomly selected. Fifty of the files selected had more than one loss per policy number. Loss of use (LOU) was tested and there were 12 files that demonstrated noncompliance with Montana case law on Loss of Use. See *Lenz Constr. Co. v. Cameron*, 207 Mont. 506, 674 P.2d 1101 (1984). Nineteen files did not have sufficient documentation on LOU in the files.

1. Underpayment or Non-Payment of Loss of Use ("LOU")

<u>NUMBER OF FILES</u>	<u>VIOLATIONS</u>	<u>INADEQUATE RECORDS</u>
<u>150</u>	<u>12</u>	<u>19</u>

One claim file with a bodily injury claim for an infant was denied by the Company as no liability on the part of the driver. This claim was paid during the examination.

2. Stacking

Section 33-23-203 (1981 – 1997), MCA, Limitation of liability under motor vehicle liability policy provides:

(3) An insurer that charges a premium for a specified coverage shall clearly inform or notify the insured in writing of the limits of the coverage with respect to the premium charged and whether the coverage from one policy or motor vehicle may be added to the coverage of another policy or motor vehicle.

The Companies attempt to limit stacking by terms in the body of the contract. The policy states " *THE LIMITS SHOWN ON THE DECLARATIONS REFLECT THE LIMITS YOU HAVE CHOSEN FOR EACH COVERAGE LISTED. IN NO EVENT SHALL THE LIMIT OF LIABILITY FOR THE TWO OR MORE VEHICLES OR TWO OR MORE POLICIES BE ADDED TOGETHER, COMBINED OR STACKED TO DETERMINE THE LIMIT OF LIABILITY AVAILABLE TO INJURED PERSONS.*" However, the Companies charge a separate bodily injury premium for each vehicle under Uninsured and Underinsured Motorists coverage in the declarations page. The following policy forms contain the referenced notice:

SA-1852/MTEP 11/00
SA-1714/MTEP 8/02

Form number SA-1852/MTEP 7/03 contains the same notice with the following added:

"...THIS NOTICE DOES NOT APPLY TO UNINSURED/UNDERINSURED MOTORISTS COVERAGE OR MEDICAL PAYMENTS COVERAGE."

When the Companies charge separate Uninsured and Underinsured premiums on multiple vehicles in the Declarations page, they cannot limit these benefits with restrictive language on the page following the declaration page and then state the benefit is actually allowed by language inserted near the end of the contract. The contract is misleading in this respect and does not meet the requirement of § 33-23-203(3), MCA, to clearly inform the insured of limits of the coverage with respect to the premium charged. See also *Danielson v. Safeco Insurance Company of America*, 20 MT.F.R. 467 (1996) and *Chilberg v. Rose*, 52 St.Rep. 1038 (1995).

CONCLUSION

The market conduct examination of American Economy Insurance Company, American States Insurance Company, First National Insurance Company of America, General Insurance Company of America, Safeco Insurance Company of America, Safeco Insurance Company of Illinois, and Safeco National Insurance Company is respectfully submitted to the Honorable Monica Lindeen, State Auditor and Commissioner of Insurance and Securities for the State of Montana.

The examiners wish to express their appreciation for the courteous and prompt cooperation and assistance of the officers and employees of the Companies during the course of the examination.

AFFIDAVIT OF EXAMINER

STATE OF MONTANA)
) ss.
COUNTY OF LEWIS AND CLARK)

Dave Drynan, AIE being duly sworn, deposes and says:

That he is the examiner representing the State Auditor and Commissioner of Insurance, state of Montana;

That pursuant to the authority vested in him by § 33-1-401, MCA, he examined the market conduct of the Safeco Companies for the period January 1, 2000, to June 30, 2004.

That to the best of his knowledge and belief, the attached report of the examination is a true and correct report of the market conduct and operations of the Safeco Companies as of June 30, 2004.

DATED this 2 day of OCTOBER, 2009.

Dave Drynan
Dave Drynan, AIE

SUBSCRIBED AND SWORN to before me this 2 day of OCTOBER, 2009.

Darla Sautter
Printed name DARLA SAUTTER
Notary Public for the State of Montana
Residing at HELENA
My commission expires 4/14/2010



AFFIDAVIT OF EXAMINER

STATE OF MINNESOTA)
) ss.
COUNTY OF RAMSEY)

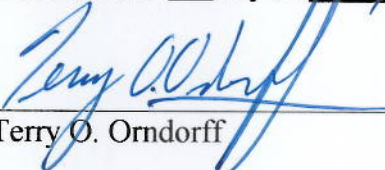
Terry O. Orndorff, JD, CFE, CPA being duly sworn, deposes and says:

That he is the examiner representing John Morrison, State Auditor and Commissioner of Insurance, State of Montana;

That pursuant to the authority vested in him by Commissioner Morrison, he examined the market conduct of the Safeco Companies for the period January 1, 2000, to June 30, 2004.

- That to the best of my knowledge and belief, the attached report of the examination is a true and correct report of the market conduct and operations of the Safeco Companies as of June 30, 2004.

DATED this 8th day of May, 2009.



Terry O. Orndorff

SUBSCRIBED AND SWORN to before me this 8th day of May, 2009

Notary Public for the State of
Residing at:
My Commission expires

